A Call for Policy Based Budgeting In an Era of Diminishing Resources and Expanding Needs

A review of the City and County of San Francisco's Budget Development and Financial Planning Process

December 2008

Prepared by the San Francisco Municipal Executives' Association and Management Partners, Inc.

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EXECUTIVE SUMMARY

The Issue:
The City and County of San Francisco is facing unprecedented adverse economic conditions in the form of a staggering global economic crisis affecting cities and counties as well as a California state budget deficit estimated at $10 billion and growing. With San Franciscans seeking sustainability of vital programs and services, and transparency of process, San Francisco government is facing serious choices about what it can afford.

The City has experienced several years of difficult budgeting, relying on hiring freezes, mid-year cuts, one-time fixes and various other balancing techniques. These stopgap measures, however, cannot continue to substitute for policy discussions aimed at identifying core priorities and programs and creating budgets that adequately fund them.

As the senior professional managers of City government operations, the members of the Municipal Executives' Association (MEA) are well aware of the consequences of the existing budget practices. As public servants, we are committed to seeking solutions that support the Mayor, the Board of Supervisors and the San Franciscans who are dependent upon the services and programs we provide.

The Context:
During the FY 2008-2009 budget development process, the Mayor's Office asked all represented employee groups for contract concessions to help close the projected budget shortfall. MEA members agreed to step forward and offer concessions worth $5 million over the 2008 and 2009 fiscal years. In exchange, MEA requested that the City and County collaborate with us on a transparent and rigorous examination of the issues that make the budget process so challenging and identify potential solutions. This document is a key element of that effort.

The Process:
MEA engaged Management Partners to assist MEA with its efforts, including conducting a survey of MEA members designed to seek opinions from people who work with the budget system daily and compiling a comparison of budgeting practices of comparable municipalities.

MEA members responded in large numbers to the survey, providing opinions about the City's budget policies and practices, and offering their ideas about ways to improve the process. The survey revealed that the

managers in City departments believe the current budget process is overly cumbersome and does not provide an opportunity to focus on policy decisions that provide guidance on managing effectively within the ever-evolving landscape of competing priorities.

At the same time, information gathered from comparable municipalities offered many useful suggestions about how the City might realign the budget process to make it more collaborative, more responsive to changing economic conditions and provide a more direct and transparent model for resolving competing service priorities.

The Challenge:

- A budget practice of iterative cuts and add backs, performed in isolation by each reviewing party
- The use of ballot measures to set-aside funding for specific purposes leaving only a small slice of the overall City budget available in any given year for the vital services not funded by set-asides
- A Rainy Day Reserve Fund that limits access by only recognizing one end of the "fiscal emergency" spectrum
- An overly complex budget process with more steps and less long-range planning than other jurisdictions
- The lack of an independent budget entity to provide analysis from an organization-wide perspective

The Proposals:

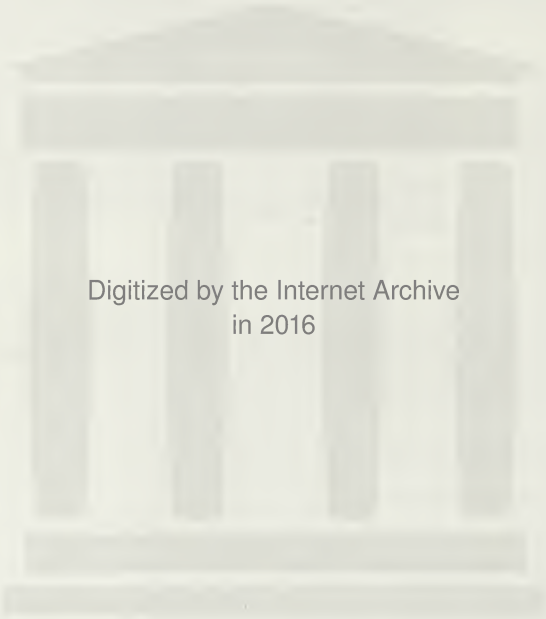
1. Establish a professional Office of Management and Budget (OMB), which will be responsible for annual budget development and financial planning for the City and County of San Francisco, and accountable to both the Mayor and the Board of Supervisors.
2. Establish budget development priorities and guidelines that are adopted by the Board of Supervisors at the start of the annual budget process in September.
3. Hold joint departmental budget hearings to review department budget submittals with the Mayor's Office and the Board's Budget Committee in mid to late February.
4. Increase the horizon of revenue forecasts from three to five years.
5. Initiate city-wide financial planning.
6. Identify and implement organization-wide fiscal strategies to create a sustainable financial structure.
7. Revise the City's Rainy Day Reserve to ensure that financial resources reserved for economic downturns can be used when they are needed.
8. Conduct full cost analysis of and include sunset clauses in all set-aside ballot measures or initiatives. Modify existing set-asides to provide flexibility in response to economic and demographic shifts.
9. Implement biennial budgeting.

The Rewards:

The potential rewards for positive change are plentiful. With a system that recognizes that policy decisions should drive budget decisions, the key priorities of policy makers can be identified, with dollars for those priorities allocated early in the process. With clear budget direction, managers can be much more effective in planning and carrying out their responsibilities to properly manage their departments and provide quality services to residents and visitors. With an independent budget office, a rigorous and centralized financial analysis of the organization-wide budget can occur. Finally, with a more collaborative process on the front end, the City can produce a budget that allocates resources consistently in a manner that reflects the service needs of residents and visitors to the City and County of San Francisco.

The City and County of San Francisco has a tradition of leadership in progressive government. Budgeting based upon clear policy directives will help safeguard the resources necessary to continue that tradition. Creating a structure that provides continuity, consistency and objectivity in its preparation, as well as transparency to the public throughout the process, frees the executive and legislative branches to tackle the difficult task of setting policy in an era of diminishing resources and expanding needs, and allows managers to focus on long-range planning and service delivery.

The Municipal Executives' Association wishes to thank all of the members and City officials, past and present, who contributed their insight, expertise and historical perspective to the preparation of this report.



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PROJECT BACKGROUND

The MEA represents over 1000 managers in departments throughout City government. MEA's mission is "***to enhance the quality of life for all San Franciscans and visitors by promoting sound government practices, supporting professional excellence for our City's managers, and maintaining the highest ethical standards in the delivery of service to the public.***"

During the FY 2008-2009, recognizing the need to provide leadership and protect programs in response to the budgetary shortfall, MEA members agreed to concessions worth $5 million over two years. MEA also requested and the City agreed to work collaboratively to determine the most effective method to fund and sustain core programs and a dedicated workforce. As a result, the City and County signed a letter of agreement with MEA which states in part:

> *"The parties agree on the need for a comprehensive approach to analyzing long-term solutions to ongoing and systemic budget deficits that integrates many possible elements, including prioritization, cost saving, enhanced revenue, legislative action and Charter reform. On behalf of, and in conjunction with, the City's managers, MEA is currently facilitating and funding a judicious analysis of the various options available to achieve that goal."*

In June 2008, the Mayor was able to present the Board of Supervisors with a balanced budget due to the elimination of numerous vacant positions, unanticipated revenue increases, delays in capital improvements, limited layoffs, program and service reductions, as well as concessions from a small number of represented employee groups.

Prior to signing the aforementioned letter, MEA had already initiated its own internal analysis and engaged Management Partners to facilitate a process with the MEA membership to develop concrete steps that leaders in the City and County of San Francisco could consider to address the budget challenges facing the government.

Management Partners is a national consulting firm, founded in 1994 to help local government leaders improve the way their organizations operate. The firm specializes in serving local governments, and has developed and refined expertise in every aspect of service that is provided by local governments.

MEA and Management Partners began this project by meeting with a cross-section of department directors and an MEA Project Steering Committee. At this meeting, Management Partners learned about the San Francisco budget situation, MEA's strong interest in providing leadership to significantly change and improve the process, as well as MEA's position and role to date. The discussion was initially focused on comparing San Francisco to other large municipalities across the nation and identifying specific budget strategies organized around the following three major themes:

1. Revenue Enhancements
2. Service Delivery Changes
3. Expenditure Controls and Shifts

At that initial meeting, the MEA members present were clear that bold and decisive action was preferable and necessary to extricate the City from a budget process that is not serving the needs or interests of any of the participants or recipients.

Once the work was underway it quickly became apparent that San Francisco operates a budget development process that is highly fragmented, unnecessarily contentious and significantly different from the other large cities in California and across the nation. There are legitimate public policy reasons for why many of the unique characteristics surrounding the San Francisco budget model developed, but MEA members believe a more rational process, which embraces the uniqueness of San Francisco government, will result in an outcome that is more satisfying and ultimately more successful.

As Management Partners reviewed the budget process, the consultants concurred with MEA that the San Francisco budget process itself is at the heart of the problem.

One of the early tasks undertaken by Management Partners was to collect information and opinions about potential budgetary strategies from MEA members. Management Partners designed and administered an on-line survey that resulted in more than 170 specific budget strategy ideas being proposed by MEA members. Because this report centers on the critical problems with how the City develops and adopts its annual budget, these specific budget strategies are provided as Attachment A. The strategies require further research and financial analysis; however, they are provided to illustrate the myriad of options that are available to the City and County once the fundamental budgeting and financial planning structure has been repaired.

City and County of San Francisco Budget Process

Prior to a discussion of the specific budgetary process issues and reform proposals that resulted from the analysis, it is necessary to provide an overview of the annual San Francisco budget development process as it is currently taking place.

The City and County of San Francisco operates on a July 1st to June 30th fiscal calendar. Each year, as required by state law, the City adopts a balanced budget that articulates how much money the government will receive and how each dollar will be spent. The Board of Supervisors must approve a balanced budget by July 1st of each year.

The FY 2008-2009 total budget for the City and County of San Francisco is $6.5 billion. The funds are used to maintain public infrastructure and provide services to the 765,000[1] residents, as well as the millions of visitors and workers who travel to San Francisco each year. The government employs 27,800 individuals, distributed among nearly 60 departments and agencies.

The annual budget development process in San Francisco usually takes 10 months to complete. As early as September, departments and agencies begin to project revenues and expenditures for the upcoming fiscal year that will begin on July 1st of the following year. The key parties participating in the annual budget development process are:

- Mayor
- Board of Supervisors
- Board's Budget Analyst
- City Controller
- Administrative Commissions
- Departments and Agencies
- City-funded organizations
- Represented Employee Groups
- Members of the Public

Annual Budget Timeline and Key Events

The following is a summary of the budget timeline and key events during the budget process.

September to December:
Departments and agencies prepare preliminary revenue and expenditure estimates. New program initiatives and major service changes for the upcoming fiscal year are analyzed and the costs and/or savings are projected by departments and agencies.

December:
The Mayor's Office, in consultation with the Controller's Office, issues budget instructions setting the overall direction for the budget of the next

[1] U.S. Census Bureau 2007 Population Estimate

fiscal year. The budget instructions contain preliminary revenue estimates that are prepared by the Controller's Office.

January to February:
Departments, the Board of Supervisors and City administrative commissions conduct hearings to obtain public comment on proposed portions of the budget. Subsequently, the administrative commissions, appointed and elected department heads, and the City Administrator submit departmental budget proposals to the Controller in late February.

Administrative commissions in San Francisco oversee the operations of specific departments and are charged with making operational decisions and providing directives to department directors. In addition, they make policy recommendations to the Mayor and Board of Supervisors regarding their service function. Their role differs from the City's advisory commissions, which are not involved in operational or budget decisions.

March:
Departmental budget submissions are consolidated by the Controller's Budget Office and forwarded to the Mayor's Office of Public Policy and Finance by the first working day of March.

April to May:
The Mayor's Office of Public Policy and Finance analyzes departmental budget submissions. The Board of Supervisors' Budget Committee may meet to deliberate on key City budget issues. Individual Supervisors may gather and assess constituent input and often hold neighborhood meetings during this time. The Mayor's analysis and the Board's deliberations take place separate and apart from one another.

By the first work day in May, the Mayor submits a proposed budget for all enterprise departments to the Board of Supervisors' Budget Committee. An enterprise department operates like a stand-alone business. Such a department generates its own revenue (often through user fees or special tax measures) and is self-sufficient, with revenues covering expenditures. San Francisco's enterprise departments include:

- Airport
- Municipal Transportation Agency
- Port
- Public Utilities Commission

June:
By the first working day in June, the Mayor's Proposed Budget for all general fund departments is presented to the Board of Supervisors' Budget Committee. The Mayor's Proposed Budget is a balanced budget that includes funding sources and expenses for enterprise departments as well as all remaining City departments and agencies. The Board's Budget Analyst begins to review the Mayor's proposed budget on behalf of the Board of Supervisors.

The Budget Committee continues its budget deliberations, reviewing all operations during its June hearings. No later than June 30th, the Board of Supervisors passes the Interim Annual Appropriation Ordinance (AAO). The Interim AAO provides the authority for the City to pay its bills when the new fiscal year starts on July 1st.

July:
No later than the last working day of July, the Board of Supervisors adopts the final budget.

Definition of the Problem

MEA members are managers of the operating departments and, as such, have significant responsibility and accountability for operations and budgets. They have grown increasingly concerned about the City's budget process, largely because the budget it produces, and the reliance on "across the board" cuts to balance that budget, do not reflect a strategic and long-term approach to ensuring and protecting the fiscal health of government operations. Because there is no central way in which City services are prioritized and policy objectives articulated, the current budget process and the adopted budgets that result from it have the potential to impact negatively service to the public. In addition, the process sets in motion a spending plan that does not stay balanced and is developed in an atmosphere of isolation and uncertainty.

The current process does not include a strategic element or structure that encourages collaboration and "big picture" analysis. As a result, four key flaws are apparent:

1. The budget process fails to fully engage the professional expertise of management staff in the City's operating departments.
2. The process does not include early collaboration between the three key parties who are responsible for the outcome of the budget process: the Mayor, the Board of Supervisors and the departments.
3. The process lacks rigorous analysis by a neutral budget staff with broad city-wide perspective and independent status.
4. The process fails to realize the benefits of long-term financial planning.

The current system is one in which each party makes separate changes to the budget independently and without benefit of collaboration or discussion with the other parties. Because each party in the process operates in isolation from each other, there are no means or incentives for encouraging people to find cost-effective ways of doing things, or to adjust their requests by understanding the whole picture. Indeed, the process rewards those who are best at the "budget game" rather than encouraging financial decision-making based on policy and service delivery needs. ***Nowhere in the process is the budget prepared or analyzed by a neutral professional manager who, while not the***

ultimate decision maker, is accountable for protecting the long-term fiscal health of San Francisco government and its core programs, and has the independence to stand up to political pressure.

Several examples from recent budget cycles point out the weaknesses and dysfunction of the current City budget process:

- **Across the board cuts:** In recent years, the Mayor's Office of Public Policy and Finance has requested across-the-board cuts expressed as a percentage of the budget. This request includes enterprise departments, which are operated as separate and stand-alone entities with their own revenue sources (the Port, Airport, Municipal Transportation Agency, Public Utilities Commission, etc.). The across-the-board cut approach means that a department with no reliance on the General Fund, with adequate revenues of its own, may still be requested to cut positions and funding that could negatively impact its operations -- for no logical reason and, perhaps, to the detriment of the service provided to residents and visitors.
- **No detailed analysis of budget submittals:** There is no entity within City government with the staff capacity to analyze, review and approve department budget submittals in detail, and to identify and work through budget cut proposals such as termination of non-profit contracts that, absent consultation, the Board of Supervisors will move to restore. No office exists with the resources to ask the hard questions and identify sound potential cuts. The Mayor's Office of Public Policy and Finance has had high turnover and fewer analysts in recent years than in the past and, as a result, the Mayor's budget analysts have less opportunity to learn about the departments' operations and dig deep into their financials. The high turnover rate results in a lack of continuity and institutional memory.
- **Fiscal decisions made without sufficient analysis:** The Board of Supervisors is often placed in a reactive mode because a department or the Mayor's Office will make cuts to a service that results in constituent complaints. In response, the Board will then work to investigate and resolve the issue. Discussions on service priorities or policy decisions on service cuts or changes do not occur early enough in the budget development process, if they occur at all. Examples include recent attempts to cut vacant recreation leader positions and reduce street sweeping service levels. During the recreation leader discussion at the February 13, 2008 Board Meeting, it was noted that the City recently spent $3.5 million to rebuild the Helen Wills Playground but the proposed recreation leader cuts would not leave enough staff assigned to keep it open. So-called "technical adjustments" are made to operating department budgets by the Mayor's Office of Public Policy and Finance after they have already been approved by the Board's Budget Committee. Some are not technical in nature but

policy-related and are made without public discussion or consideration of service impacts.

- **Charter amendments that impede professional budgeting practices:** The 1996 Charter, passed by voters, made substantial changes to the budget process. Prior to 1996 the Board of Supervisors was permitted to make cuts to the budget presented to them by the Mayor, but could not reallocate the monies realized by those cuts. The 1996 Charter permits the Board to reallocate the funds it cuts. These reallocations are called "add backs." The result is that the Board has a strong incentive to cut the Mayor's budget. This pivotal change transformed the role of the Board's Budget Analyst, who is responsible for reviewing the Mayor's budget on behalf of the Board. Specifically, prior to 1996 the Budget Analyst identified reductions based on the goal of improving the City's bottom line financial position; since 1996 the Budget Analyst's recommendations have often been used to find cuts so that the funding can be reallocated to pay for supervisor add backs.

- **Focus on the short term:** Because the lack of long-term planning and the absence of agreement on core priorities often result in ongoing changes to the budget, City managers are placed in an untenable position as they cannot manage with any long-term strategic view. Often, they cannot defend or justify decisions made regarding their department budgets, and yet are the first to be held accountable for department performance.

- **Set-asides permanently lock up dollars regardless of the need to fund new or higher value services:** In addition to issues with the budget development process, MEA members expressed significant concern about how financial set-asides are structured in San Francisco. In recent years, the residents of San Francisco have passed several ballot measures that set-aside funding for specific purposes. These set-asides result in compulsory budgeting decisions, which must be repeated in subsequent budgets, regardless of the City's financial position or changes in demographics, priorities or needs. As a result, financial resources are allocated by pre-set mathematical formulas, which severely limit the ability of City and County leaders, both elected and appointed, to reallocate resources based on changing service needs or economic conditions.

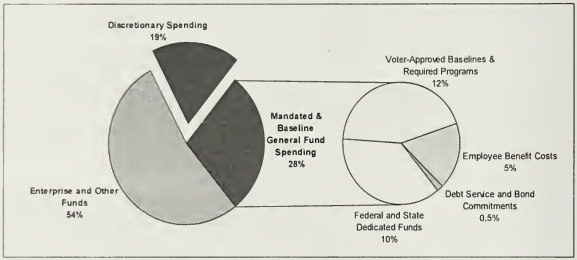
MEA members are concerned that as a result of set-asides, often approved without the benefit of analysis on their full costs or impact on other vital services, there is only a small slice of budget pie that remains discretionary. The Controller's Office states in its Revenue Letter for Fiscal Year 2008-2009:

> *After factoring in the above key baselines, set-asides, and Charter-mandated spending as well as grant and federal, state and local employment provisions, the General Fund*

> *has an 'effective' level of discretionary spending capacity of approximately 40 percent of total General Fund revenues and transfer-in sources. Said another way,* ***only about $1.21 billion of the total $6.53 billion total City budget is available for general discretionary spending.*** *[emphasis added]*

The chart below offers a visual perspective on the City's total budget position, and a breakdown of discretionary, mandated, baseline and enterprise spending. Set-asides are shown as "voter-approved baselines and required programs."

TOTAL CITY AND COUNTY OF SAN FRANCISCO BUDGETED SPENDING IN FY 2008-2009[2]



The City begins each budget year with limited decision making authority about how tax dollars should be spent. It is, in essence, painted into a financial corner without the necessary flexibility to determine policy and service levels on their merits from year to year. Some of those departments who are beneficiaries of set-asides stated that at times, they have difficulty spending all the funds allocated to them. Those services provided within the discretionary spending slice are at repeated high risk for continued cuts as the set-asides slowly crowd them out. This is not a budgeting structure that enables policy makers to adjust funding as needs change over time. In local government, needs and demands frequently change.

On April 15, 2008, Mayor Gavin Newsom placed on the ballot a measure declaring that it be the official policy of the City that no new set-asides or other mandatory appropriations can be added to the Charter unless the measure also identifies or provides a specific, adequate new source of

[2] Source: San Francisco Office of the Controller Revenue Letter (Fiscal Year 2008-09)

funds. In a related press statement, the Mayor stated that "the impact of these set-asides has limited the ability of both the Mayor and Board of Supervisors to effectively respond to budget deficits, and has led to reductions in important public services due to the declining portion of the budget available for discretionary spending."

On November 4, 2008, San Francisco voters overwhelmingly approved this policy directive.

Concurrent Efforts Related to the Budget

Given recent budget deliberations and the City's difficult financial position in recent years, there appears to be consensus building that reform is needed.

In a press release in July 2008, Mayor Gavin Newsom asked Controller Ben Rosenfield to convene a working group of economic and financial professionals, organized labor, the Board of Supervisors and other stakeholders to work toward addressing the City's structural budget issues and bringing long-term balance to the City's finances.

In response to the Mayor's request, the Controller's Office has recently begun a "Budget Improvement Project" to review barriers to the achievement of long-term, structural balance in the City's budget. According to a September 25, 2008 memo from the Office of the Controller, the project will focus on the following areas:

- A review of the processes and policies the City uses to plan for, prepare, and adopt the annual budget
- A review of spending and revenue growth during the past decade, focusing on the categories of spending that have outpaced the growth of revenues used to pay for them
- The sustainability and diversification of the tax and fee revenues used to support City services
- A comparison of targeted revenue and expenditure categories versus peer cities and counties

Several working groups, comprised of a cross-section of City financial professionals and managers from across the organization, are meeting to provide research, content, and produce the report. Working group topics include those reviewing expenditure and revenue, comparison to peer cities and counties, best practice financial policies, and the budget and planning process. A Project Executive Review Committee will provide feedback to the Controller's Office on papers and recommendations prior to a final report later this month. All indications are that the separate work done by the Controller and MEA is complimentary, and we look forward to integrating all the recommendations into a single, cohesive approach.

PROJECT APPROACH

Management Partners used a number of analytical techniques and data-collection methods in its assessment. These combined steps enabled the project team to acquire an organization-wide picture of common themes and issues regarding the budget process, as well as to cross-reference and verify assertions. The interviews with MEA members, benchmarking research, and the review of data and written documents assisted in the development of reform proposals to streamline and improve the City's budget development and financial planning process.

Document and Data Review

A variety of City documents and data were reviewed and referenced during the study. These included:

- 2007 Comprehensive Annual Financial Report (CAFR)
- Adopted Budgets
- Board of Supervisors Budget Analyst's Special Project and Management Audit Reports
- Budget Process Guide, "A Guide to San Francisco's Budget Process"
- Budget Process Ordinance
- City Controller 3-Year Budget Projections
- City Controller Budget Status Reports
- City Controller Economic Impact Reports
- City Controller Monthly Economic Barometer Reports
- City Controller Organization-wide Individual Management Reports
- City Controller Revenue Letters (last three fiscal years)
- City Services Auditor Reports
- Departmental Efficiency Plans
- Mayor's Budget Instructions for Department Heads and Chief Financial Officers
- Mayor's Business Process Reengineering Policy Paper
- Mayor's Proposed Budgets (last three fiscal years)
- San Francisco Administrative Code
- San Francisco Charter

MEA Membership Survey

Management Partners worked with MEA to develop and administer an electronic survey to MEA members to elicit strategy ideas under three distinct categories, which included:

1. Service Offerings and Delivery Changes
   This includes changing work rules, organizational structure and policies to deliver services at less cost than the current approach, and the reduction or elimination of services deemed to be of lesser priority.
2. Expenditure Controls/Shifts
   This includes steps to reduce the growth of expenditures while preserving service levels, including shifting various expenditures from the General Fund to other special purpose funds, which may require organizational or operational charges.
3. Revenue Enhancements
   This includes measures such as raising taxes and fees to increase revenue.

In addition, the survey asked MEA members to identify other local governments they would suggest for comparison to the City and County of San Francisco. The survey information served as a launching point for discussions with the MEA Project Steering Committee about the selection of peer jurisdictions and possible budget strategies that necessitate further study.

The initial scope of this review focused upon identification and selection of specific strategies to improve the City's operations and financial position. However, during subsequent discussions with the MEA Project Steering Committee and based upon preliminary results of the budget process benchmarking, the project focus evolved into an examination of the City's budget development and financial planning processes. Nevertheless, MEA members did identify specific budget strategies and the means to categorize them. This work is shared in this report as Attachment A with the anticipation that the City and MEA will take action on them in the future.

Peer Benchmarking

Management Partners conducted benchmarking with other large municipalities on several data points and compared budget development and financial planning processes in those jurisdictions with the City and County of San Francisco. The uniqueness of San Francisco's government structure was an important factor in the determination of suggested peers. In addition to specific characteristics of merged consolidated cities and counties, several other factors in fluenced the selection of peers. The factors included, but were not limited to: (1) population density, (2) recommendations from MEA members, (3) tourist levels, (4) existence of

coterminous city and county boundaries, (5) percentage of the city population living within the county borders, and (6) international importance – assessed based on a Global City designation[3].

Through the electronic survey, MEA membership identified the entities they felt most appropriate for comparison to the City and County of San Francisco. Table 1 below provides a summary of the responses.

TABLE 1: RESPONSES TO SURVEY QUESTION 15, APPROPRIATE COMPARISON TO MERGED/CONSOLIDATED U.S. CITY AND COUNTY GOVERNMENTS

Answer Options	Response Percent
City of Boston and Suffolk County, Massachusetts	55.00%
New York City, New York	43.30%
City of Philadelphia and Philadelphia County, Pennsylvania	41.70%
City and County of Denver, Colorado	38.30%
City and County of Honolulu, Hawaii	30.00%
Other (see below)	26.70%
Washington, D.C.	20.00%
City of New Orleans and New Orleans Parish, Louisiana	5.00%
City of Nashville and Davidson County, Tennessee	3.30%
City of Indianapolis and Marion County, Indiana	1.70%
City of Jacksonville and Duval County, Florida	1.70%
City of Louisville and Jefferson County, Kentucky	0.00%
Municipality of Anchorage, Alaska	0.00%

The most frequently mentioned cities in the "Other" category included Los Angeles, Seattle, and Chicago. The cities of San Jose, Phoenix and Minneapolis were also mentioned as appropriate for comparison.

To define the selected peer jurisdictions, Management Partners further analyzed a list of large U.S. cities/counties based on the factors that are articulated above. Table 2 shows the results of this comparison for a variety of large U.S. cities and counties. Those jurisdictions shaded in gray were approved by Management Partners and the MEA Project Steering Committee to serve as peer agencies for further benchmarking comparison and are referenced as such throughout this document. Several large California cities, such as Los Angeles, San José and San Diego, are included as peer agencies because they operate under the same state legal environment as San Francisco.

[3] A Global City is typically defined as a city that is often recognized to be an important node in the global economic system. Such cities may also be distinguished by their participation in international finance, active influence and participation in global events, advanced transportation systems, and world-renowned cultural institutions.

TABLE 2: CRITERIA FOR SELECTION OF PEER AGENCIES

Municipality (Suggested peers are highlighted in gray)	Merged and Consolidated Cities and Counties	Global City	Recommended by Survey Respondents	Tourist Cities (Top 10 Most Visited US Cities[4])	Coterminous City and County	Percentage of City Population in the County	Population Density (Cities and Coterminous City/County Govt's)	
							Top 10 Densely Populated Cities	Population per sq. mile of land area
City and County of Denver	✓		✓		✓	100%		6
City and County of Honolulu	✓		✓	✓		42%		7
City and County of San Francisco	✓	✓		✓	✓	100%	✓	26
City of Atlanta *(and Fulton County)*		✓				51%		5
City of Boston and Suffolk County	✓	✓	✓	✓		85%	✓	19
City of Chicago *(and Cook County)*			✓	✓		54%	✓	20
City of Dallas *(and Dallas County)*		✓	✓			54%		5
City of Indianapolis and Marion County	✓					91%		3
City of Jacksonville and Duval County	✓					94%		2
City of Los Angeles *(and Los Angeles County)*		✓	✓	✓		39%	✓	12
City of Louisville and Jefferson County	✓					37%		6
City of Miami *(and Miami-Dade County)*				✓		16%	✓	16
City of Minneapolis *(and Hennepin County)*			✓			34%	✓	11
City of Nashville and Davidson County	✓					96%		2
City of New Orleans and New Orleans Parish	✓				✓	100%		4
City of Philadelphia and Philadelphia County	✓				✓	100%	✓	18
City of Phoenix *(and Maricopa County)*			✓			43%		4
City of San José *(and Santa Clara County)*		✓	✓			53%		8
City of San Diego *(and San Diego County)*						43%		6
City of Seattle *(and King County)*			✓			32%	✓	10
Municipality of Anchorage, Alaska	✓				✓	100%		0.2
New York City, New York		✓	✓	✓	✓	100%	✓	41
Washington, D.C.			✓	✓		n/a	✓	15

Information from the benchmarking research component of this project was useful in determining where San Francisco's budget development and financial planning process and organization structure differs from its peers. The benchmarking results are provided in the next section of this document.

[4] The remaining Top 10 Most Visited US Cities that are not shown are Orlando, Florida and Las Vegas Nevada (based on the annual number of arrivals in 2007)

ANALYSIS

As part of the benchmarking review, Management Partners identified similarities and differences in the City's budget development and financial planning processes with those in peer agencies. Management Partners used publicly available information on websites, in budget documents, and when necessary, contacted peer agencies to identify the specific and unique steps in their budget development and financial planning processes. In addition, each agency was contacted to confirm the accuracy of the benchmarking information that appears in this report.

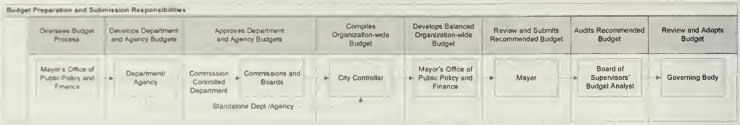
Budget Process Comparisons

Overview

Management Partners reviewed the steps of each peer jurisdiction's budget process to identify which unit within the government creates the initial budget, which individual approves that version, when policymakers review and approve it, etc. Our review found that the peer agency budget processes fall into what can be categorized as three different scenarios as described below. The third scenario is, by an overwhelming margin, the most prevalent among the peer jurisdictions included in the benchmarking study.

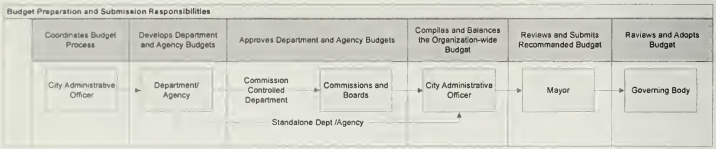
Scenario One: Scenario One is unique to San Francisco. Under this scenario, the Mayor's Office of Public Policy and Finance coordinates the budget development process, which begins with each department preparing an initial budget. If an administrative commission controls the department, the commission subsequently reviews and recommends the budget. Next, all departments submit their budgets to the City Controller who compiles and forwards an unbalanced organization-wide budget to the Mayor's Office of Public Policy and Finance for review and development of a balanced budget. The Mayor then submits a proposed budget to the Board of Supervisors where it undergoes the scrutiny of the Board's Budget Analyst. Next, the budget document and the Budget Analyst's suggestions for cost savings are returned to the Board of Supervisors. The Board then reallocates the funds identified by the Budget Analyst as cuts to the Mayor's Budget to fund other programs, a process commonly referred to as the "add back process". Finally, the Board votes to approve the budget. *It is significant that the City and County of San Francisco's budget process is unique and arguably the most complex among the peer jurisdictions.*

Scenario One Budget Process



Scenario Two: Scenario Two represents the budget process in the City of Los Angeles. Under the Los Angeles scenario, the City Administrative Officer coordinates the budget development process and the operating department prepares a budget which is then reviewed by either an administrative commission or Board or by the City Administrative Officer (for departments without an administrative commission). This budget is then submitted to the Mayor for review and then to the governing body (e.g. Board of Supervisors, City Council) for review and approval.

Scenario Two Budget Process



Scenario Two is used solely by the City of Los Angeles and, while this scenario is most similar to that used by the City and County of San Francisco, it still differs considerably. The City of Los Angeles has fewer commissions with budget authority than San Francisco and has a budget development organization that is separate from the Mayor's office. In addition, the Los Angeles City Administrative Officer is appointed by the Mayor, confirmed by the City Council, and is responsible for ensuring the long-term financial health of the City. To this end, the City Administrative Officer also oversees city-wide financial policies, risk management, debt management and investor relations.

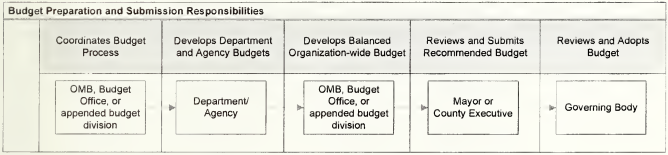
Further, unlike San Francisco, the City of Los Angeles does not have a separate audit review function.

Scenario Three: Scenario Three represents the most common budget process structure employed by the jurisdictions in the benchmarking study. Under this scenario, the party that is charged with coordinating the budget process as well as compiling and balancing the organization-wide budget is either:

- A Budget Office or Office of Management and Budget (as an organizational department)
- A budget division within the office of the City Administrator, City Manager, or County Manager
- A budget division within an organizational department (Finance or Treasury)
- A budget division within the office of an elected County Executive

Irrespective of the specific organizational unit responsible for budget coordination and development of the balanced budget, the general sequence of the budget development process is analogous. After the operating department prepares an initial budget, the organization-wide budget is prepared and balanced, and subsequently forwarded to the executive (the Mayor or, in the cases of King and Cook counties, the elected County Executive). The recommended budget from the elected executive branch is then forwarded to the governing body for review and adoption.

SCENARIO THREE BUDGET PROCESS


Budget Preparation and Submission Responsibilities
Coordinates Budget Process
Develops Department and Agency Budgets
Develops Balanced Organization-wide Budget
Reviews and Submits Recommended Budget
Reviews and Adopts Budget
OMB, Budget Office, or appended budget division
Department/ Agency
OMB, Budget Office, or appended budget division
Mayor or County Executive
Governing Body

Scenario Three is used by every peer agency in the study with the exception of the City of Los Angeles. The municipalities using the Scenario Three budget process are:

- City and County of Denver, CO
- City and County of Honolulu, HI
- City of Boston, MA
- City of Chicago, IL
- City of Philadelphia and Philadelphia County, PA
- City of Phoenix, AZ
- City of San Diego, CA[5]
- City of San José, CA
- City of Seattle, WA
- Cook County, IL
- King County, IL
- Los Angeles County, CA
- Maricopa County, AZ
- New York City, NY

[5] The City of San Diego's budget process includes the additional step of a review of the Mayor's recommended budget by an "Independent Budget Analyst," as directed by the City Council.

Examined at a macro level, the defining characteristics of the budget process in the above jurisdictions are the same. At a micro level, however, each entity has nuances that reflect the unique context of their governmental setting. Such nuances do not change the fact that the core structure of the budget process is remarkably similar. The observation that the City and County of San Francisco's budget process is the most complex is an important one. San Francisco's process has at least three additional steps that most peers do not. These are:

1. Inclusion of administrative commissions and boards in approving departmental budgets
2. Review of the Mayor's proposed budget by an independent auditor that is outside of the City's financial staff
3. Use of the City Controller's Office in an administrative capacity to compile an unbalanced organization-wide budget

Parties Responsible for Recommending and Coordinating the Organization-wide Budget Process

Another item that was benchmarked against peers is the party responsible for recommending the budget to the municipal governing body. In San Francisco and in the peer jurisdictions, the individual that recommends the budget to the governing body is prescribed by the governing structure of the municipality, and is commonly referred to as the chief executive officer (irrespective of the specific position title). In San Francisco and in eleven of the fifteen peer jurisdictions, the chief executive officer of the government is an elected position (a Mayor, President of the Board of Commissioners, or County Executive). Four peers have an appointed professional who serves as the chief executive officer (a City Manager, County Manager, or Chief Executive Officer). Table 3 shows the results of this review.

TABLE 3: PARTY RESPONSIBLE FOR RECOMMENDING THE ORGANIZATION-WIDE BUDGET TO THE GOVERNING BODY IN SAN FRANCISCO AND PEER AGENCIES

Municipality	Party that Recommends Budget to Governing Body
City and County of San Francisco	Mayor
City and County of Denver	Mayor
City and County of Honolulu	Mayor
City of Philadelphia and Philadelphia County	Mayor
New York City	Mayor
City of Boston	Mayor
City of Chicago	Mayor
• Cook County	President of the Board of Commissioners (an elected position which also serves as the County's Chief Executive Officer)
City of Los Angeles	Mayor
• Los Angeles County	Chief Executive Officer
City of Phoenix	City Manager
• Maricopa County	County Manager
City of San José	City Manager
City of San Diego	Mayor
City of Seattle	Mayor
• King County	County Executive (an elected position which also serves as the County's Chief Executive Officer)

Table 4 illustrates that San Francisco and King County, Washington, are the only agencies that have organizational structures that allocate the responsibility for coordinating the budget development process and the organization-wide budget staff as a direct division of an elected official's office. In these two agencies, the individual that oversees the organization unit that includes the budget division is the elected chief executive officer of the government. In the other fourteen peer jurisdictions, the unit that coordinates the budget process and prepares a balanced organization-wide budget is located under the direction of the elected Mayor and the governing body, and the individual that oversees the unit is a non-elected professional manager.

Table 4 also describes the appointing process for the budget officer in San Francisco, and similar positions in the peer jurisdictions.

TABLE 4: PARTY RESPONSIBLE FOR COORDINATING THE ORGANIZATION-WIDE BUDGET IN SAN FRANCISCO AND PEER AGENCIES

Municipality	Party That Coordinates Budget Process	How Budget Officer is Appointed
City and County of San Francisco	Mayor's Office of Public Policy and Finance	Mayoral appointee
City and County of Denver	Department of Finance – Budget & Management Office	Appointed by the Chief Financial Officer (the Chief Financial Officer is a mayoral appointee)
City and County of Honolulu	Department of Budget and Fiscal Services	Mayoral appointee, subject to confirmation by the City Council
City of Philadelphia and Philadelphia County	Office of the Director of Finance – Office of Budget and Program Evaluation	Appointed by the Director of Finance (the Director of Finance is a mayoral appointee)
New York City	Office of Management and Budget – Office of the Mayor	Mayoral appointee
City of Boston	Office of Budget Management – Finance Department	Mayoral appointee
City of Chicago	Office of Budget and Management	Mayoral appointee, subject to confirmation by the City Council
• Cook County	Department of Budget Management Services	Appointed by the County's Chief Executive Officer
City of Los Angeles	City Administrative Officer	Mayoral appointee, subject to confirmation by the City Council
• Los Angeles County	Chief Executive Office	Mayoral appointee
City of Phoenix	Budget and Research Department	Appointed by the City Manager (the City Manager is appointed by the City Council)
• Maricopa County	Office of Management and Budget	Appointed by the County Manager (the County Manager is appointed by the Board of Supervisors)
City of San José	Budget Office (in City Manager's Office)	Appointed by the City Manager (the City Manager is appointed by the City Council)
City of San Diego	Department of Financial Management, under Chief Financial Officer	Appointed by the Chief Financial Officer (the Chief Financial Officer is a mayoral appointee)
City of Seattle	Department of Finance	Mayoral appointee
• King County	County Executive Office - Office of Management and Budget	Appointed by the County Executive (the County Executive is an elected position)

Management Partners also examined if peer agencies have a separate office or staff to provide analytical budgetary support to the legislative branch. As noted above, San Francisco has an independent Board Budget Analyst that works solely for the Board of Supervisors. The support is provided via contract by a private firm. Table 5 illustrates which municipalities have separate budgetary support for the legislative branch. Such support is provided in seven of the fifteen peer jurisdictions.

TABLE 5: MUNICIPALITIES WITH INDEPENDENT LEGISLATIVE BUDGET OFFICES OR DEDICATED LEGISLATIVE BUDGET STAFF

Municipality	Independent Legislative Budget Office or Dedicated Budget Staff
City and County of San Francisco	Yes, Board's Budget Analyst (contract staff)
City and County of Denver	Yes, dedicated legislative budget staff
City and County of Honolulu	Yes, Office of Council Services
City of Philadelphia and Philadelphia County	No
New York City	Yes, Independent Budget Office[6]
City of Boston	No
City of Chicago	No
• Cook County	No
City of Los Angeles	Yes, Office of the Chief Legislative Analyst
• Los Angeles County	No
City of Phoenix	No
• Maricopa County	No
City of San José	No
City of San Diego	Yes, Independent Budget Analyst
City of Seattle	Yes, Council Central Staff
• King County	Yes, dedicated legislative budget staff

Budget Cycle

With the exception of the Municipal Transportation Agency, the City and County of San Francisco allocates financial resources on a single fiscal year basis, with a new budget created each year for the subsequent fiscal year. In November 2007, San Francisco voters recently altered the

[6] The Independent Budget Office was established in 1996 as a publicly funded agency dedicated to enhancing understanding of New York City's budget by providing nonpartisan budgetary, economic, and policy analysis for the residents of the city and their elected officials. The agency does not report to any particular entity

Charter to require that the Municipal Transportation Agency (MTA) produce biennial budgets covering two fiscal years in each even-numbered year.

Another point of comparison among the benchmark agencies was the period covered by the budget. Table 6 shows the time period of the adopted budget.

TABLE 6: BUDGET PERIOD IN SAN FRANCISCO AND PEER AGENCIES

Municipality	Adopted Budget Period
City and County of San Francisco	Single Fiscal Year (except MTA, which is biennial
City and County of Denver	Single Fiscal Year
City and County of Honolulu	Single Fiscal Year
City of Philadelphia and Philadelphia County	Single Fiscal Year
New York City	Single Fiscal Year
City of Boston	Single Fiscal Year
City of Chicago	Single Fiscal Year
• Cook County	Single Fiscal Year
City of Los Angeles	Single Fiscal Year
• Los Angeles County	Single Fiscal Year
City of Phoenix	Single Fiscal Year
• Maricopa County	Single Fiscal Year
City of San Diego	Single Fiscal Year
City of San José	Single Fiscal Year
City of Seattle	Biennial
• King County	Single Fiscal Year

As can be seen, most governments use a one-year budget cycle. Only the City of Seattle and the Municipal Transportation Agency in San Francisco[7] adopt a biennial budget, which provides a budget for the subsequent two fiscal years. Increasingly, however, more governments are transitioning to a two-year budget to increase the focus on long-term financial planning and to reduce the administrative overhead cost of having staff prepare a budget every year. However, the single year budget life cycle does not appear to be an impediment in the operation of a large city/county agency since the majority of peers operate in this manner.

Revenue Forecasts and Financial Planning

Another item benchmarked was whether peer agencies make forecasts of their various revenue sources and whether they create a long-range financial plan to guide the city over the course of several years. A revenue forecast is a projection of financial resources of an organization

[7] A biennial budget cycle for the Metropolitan Transportation Agency was authorized by voters in 2007.

that extends beyond the upcoming budget cycle. A financial plan is a comprehensive multi-year projection of organization-wide revenues and expenditures. Table 7 below shows the results of this review.

TABLE 7: REVENUE FORECASTING AND FINANCIAL PLANNING IN SAN FRANCISCO AND PEERS AGENCIES

Municipality	Revenue Forecasts	Financial Plan
City and County of San Francisco	Yes, 3-Year	No
City and County of Denver	No[8]	No
City and County of Honolulu	Yes, 7-Year	No
City of Philadelphia and Philadelphia County	Yes, 5-Year	Yes, 5-Year Financial and Strategic Plan
New York City	Yes, 5-Year	Yes, 5-Year Financial Plan
City of Boston	No	No
City of Chicago	Yes, 3-Year	No
• Cook County	No	No
City of Los Angeles	Yes, 5-Year	Yes, 5-Year Financial Plan
• Los Angeles County	Yes, 5-Year	No, 2002 Strategic Plan (with Financial Goals)
City of Phoenix	No	No
• Maricopa County	Yes	Yes
City of San Diego	Yes, 5-year	Yes, 5-Year Financial Plan (first one prepared in 2006)
City of San José	Yes, 5 year	Yes, 5-Year Financial Plan
City of Seattle	Yes, 5-Year	No
• King County	Yes, 3-Year	Yes, 3-Year

As can be seen, results were split with eleven of the fifteen peer agencies making long-range revenue forecasts and seven performing long-range financial planning. San Francisco is among the minority in doing three-year revenue forecasting and with the majority having no long-range financial plan.

Set-asides

In recent years, the residents of San Francisco have passed several ballot measures that "set-aside" funding for specific purposes. Examples of set-aside funds that were allocated by pre-set mathematical formula in the San Francisco Charter are:

- Municipal Transportation Authority, $195.72 million
- Children's Services and the Children's Fund Set-aside, a total of $149.69 million
- Library Preservation Funds, a total of $82.52 million
- Park, Recreation and Open Space Fund, $36.26 million
- Public Education Enrichment Fund, $33.75 million

[8] The City and County of Denver has initiated an effort to develop systematic, ongoing multi-year projections of both revenues and expenditures.

Examples of set-asides that are not quantified by dollars but that do impact the availability of resources city-wide include:

- Staffing Minimums for Police and MTA
- Mandated Number of Fire Stations
- Minimum Salary Requirements for MTA

As previously noted, these set-asides enforce inflexible budgeting decisions that must be adhered to in subsequent budgets, regardless of the City's financial position or changes in demographics, priorities or needs.

The use of ballot initiatives for set-asides in California has significantly increased in the last 30 years. Since the 1978 passage of Proposition 13, it has become increasingly common for communities to use set-asides as a vehicle to raise and dedicate dollars for specific services that were typically funded through increases in the local property tax, an option that was eliminated with the adoption of Proposition 13.

The use of ballot initiatives for set-asides and other mandates on San Francisco's resources adds considerable complexity for voters and staff alike. This is illustrated by the fact that the November 2008 ballot included 22 City initiatives and the Voter Information Pamphlet was over 260 pages long, making it difficult for the average voter to read and absorb. Typically, the voter is informed about the size of the set-aside, but has no way of knowing how the set-aside will impact other vital services.

Peer jurisdictions were contacted to request information regarding set-asides and five peers provided information. As noted below in Table 8, based on the peers that responded.

TABLE 8: SET-ASIDES OF PEER AGENCIES

Municipality	Set-aside Information
City and County of San Francisco	San Francisco has several set-asides have been created by way of ballot measures approved by the voters which allocate a large percentage of the San Francisco budget for specified purposes.
City and County of Denver	Denver has one set-aside that is stipulated in the administrative code (not charter). The set-aside requires that CIP projects provide one percent of project costs to support the arts.
City and County of Honolulu	Honolulu's set-asides are defined by Charter. Funds are appropriated through the annual budget process; some are allocated in the operating budget, while others are in the capital improvement program budget.
City of Los Angeles	Los Angeles has a Reserve Fund Policy with a goal of 5% that is separated into two parts that cover set-asides governed by the Charter and policy decisions of the City Council. For example, by policy there are set-asides for Affordable Housing and Cultural Affairs.
City of Phoenix	City of Phoenix does not have any set-asides.
Maricopa County	Maricopa County does not have any set-asides.
City of San José	San José has two primary set-asides, one for reserves and one a breakdown of Transit Occupancy Tax proceeds to fund the Convention and Visitor's Bureau and the Fine Arts Commission. Both were adopted by ordinance and reside in the Municipal Code.

As can be seen, those peers responding to our survey either do not have set-asides or have fewer than in San Francisco, and in many cases, the amount is flexible and can be determined each year as a policy discussion during budget deliberations.

REFORM PROPOSALS

Budget Development and Financial Planning Process Proposals

Based upon the above analysis, the San Francisco Municipal Executives' Association and Management Partners present the following proposals to improve the budget process and long-term financial sustainability of the City and County of San Francisco government.

The following proposals have been developed after reflecting on the ideas and comments of MEA members as well as those of individuals who have previously served the City and County of San Francisco in various capacities closely related to the budget process. They reflect best professional practices but are tailored specifically for the San Francisco governance setting. **Because there is a close relationship between governance arrangements and the budgetary process, the proposals are intended to respect the underlying process of governance in San Francisco while improving the process itself.** The intent is to augment the work of the City's Controller and to elevate the role of the Board of Supervisors and their Budget Analyst in the earlier stages of budget development.

The central issue that this study identified is the lack of an independent budget office that has central accountability to policy makers for protecting the long-term fiscal health of San Francisco and its core programs, and has responsibility for facilitating early collaboration and input on the policy level.

> **Reform Proposal 1: Establish a professional Office of Management and Budget (OMB), which will be responsible for annual budget development and financial planning for San Francisco government, serving both the executive and the legislative branches.**
>
> The OMB would replace and absorb the primary functions of the Mayor's Office of Public Policy and Finance and ultimately, the Board of Supervisors Budget Analyst. The OMB would also be responsible for organization-wide financial planning which is currently not performed by any division of San Francisco government.

At its core, the OMB would be responsible for developing a balanced organization-wide budget based on the principles and policy direction of elected officials. As such, OMB would provide a proposed balanced budget to the Mayor and support the Mayor in preparing a recommended budget for the Board of Supervisors on May 1 (for enterprise departments) and June 1 (for all other departments).

Throughout the process, the OMB would be charged with analyzing budget proposals at the request of the Board of Supervisors and working with the Board as they develop the final budget document that will be adopted by the Board. As a result, the function of the Board's Budget Analyst would be focused on the larger policy perspective the Board would provide to the OMB. In addition the Budget Analyst would continue to work with the Board to identify, analyze and incorporate legislative proposals.

Under this proposal, the Director of OMB could be hired in one of the following ways:

- Through appointment by the Mayor and confirmation by the Board of Supervisors;
- Through the creation of a permanent Civil Service position; or,
- Through a fixed term appointment of not less than ten (10) years.

The reporting relationship of OMB to other City officials could follow one of three potential models:

- Reporting to the Controller as a member of that office;
- Reporting to a reinvigorated City Administrator; or
- Reporting directly to the Mayor and Board.

The hiring structure of the Director of OMB and the position's relationship to other City officials should ensure accountability to both the Mayor and the Board of Supervisors, while also providing the Director with the professional elevation and independence that is necessary to administer the budget development and financial planning functions articulated above.

The majority of staffing for the new OMB unit can likely be comprised of current City and County employees from budget staff in the Mayor's Office of Public Policy and Finance and other budget staff throughout the City. Through the reallocation of budget staff and financial resources that are currently dedicated to the budget development process, it is likely that implementation of a new OMB unit could be achieved with no added cost.

The OMB could be implemented using one of three potential mechanisms:

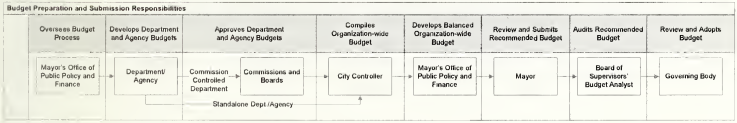
- By the Executive Branch Reorganization authority granted the Mayor in Charter Section 4.132
- By Charter amendment initiated by the Mayor or the Board of Supervisors
- By Charter amendment achieved through the initiative process

The principal responsibilities of a new OMB, as described above, will have similar characteristics to Office of the City Administrative Officer in the City of Los Angeles and OMB departments in the City of New York, City of Philadelphia, and City of Chicago.

The creation of an Office of Management and Budget with overall responsibility for the budget, supporting both the executive and legislative branches of government, will bring San Francisco's budget process in closer alignment to Scenario Three of the benchmark findings (page 21). As noted earlier, Scenario Three is used by nearly every peer jurisdiction, with the significant difference relating to the City and County of San Francisco's commission governance structure. Both the current San Francisco budget process and the revised process as it would operate under Reform Proposal 1 are illustrated below.

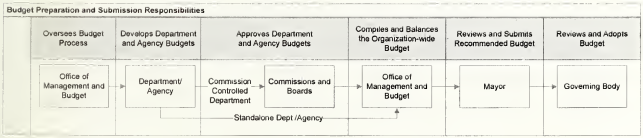
The following chart illustrates the current San Francisco budget process.

EXISTING CITY AND COUNTY OF SAN FRANCISCO BUDGET PROCESS



The following chart illustrates the City and County of San Francisco budget process as revised with Reform Proposal 1 included.

CITY AND COUNTY OF SAN FRANCISCO BUDGET PROCESS WITH REFORM PROPOSAL 1



Reform Proposals 2 and 3 are intended to maximize the opportunity for aligning policy priorities with the budget by ensuring that communication and collaboration happens early and is focused on policy rather than budget items. This can be implemented as the process currently exists. To the extent the OMB is implemented, that office would be tasked with facilitating these proposals. The primary way to reduce the disjointed nature of the current budget process is to have a more collaborative process, and to have that collaboration occur early in budget development, rather than at the end.

Reform Proposal 2: Establish budget development priorities and guidelines that are adopted by the Board of Supervisors at the start of the annual budget process (September). The Board of Supervisors should be allowed to state their priorities and guidelines for the development of the budget at the start of the process. This will reduce surprises and increase the communication of expected budgetary targets between the Board, its constituents and City departments. The adopted priorities and guidelines should be informed by preliminary revenue and expense projections developed by the Controller (or the OMB, once implemented).

The Controller should brief the Board of Supervisors' Budget Committee on the latest revenue and expense projections, as well as review preliminary budget instructions that the Mayor will issue to departments, including the rationale for the approach contained therein. The Controller should also quantify the value of the expected cost increases, offsets, and reductions. The Board should have an opportunity at this point, *early in the process*, to identify those policies and priorities which they believe should be reflected in the budget as well as those areas which may be of lower priority if they so choose.

Reform Proposal 3: Hold joint departmental budget hearings to review department budget submittals with the Mayor's Office and the Board's Budget Committee (mid to late February). The hearings would take place after the administrative commissions have approved the budgets for their respective departments.

To aid discussion at these hearings, the Controller would compile all Budget Instructions Forms 1A, "Summary of Major Changes" or comparable document, and submit these to the Mayor and Budget Committee. The Board's Budget Analyst could then provide input. The Budget Committee could hold a series of public hearings/workshops to discuss the impact of proposed reductions or service changes. The department heads

appearing at these workshops would explain the logic of their proposed reductions and the impact of such changes. Per San Francisco's Sunshine Ordinance (Administrative Code Chapter 67), the hearings would be public. Following the hearings, the Board's Budget Committee would discuss the impact of the proposed budget submittals and provide policy recommendations and/or direction to the Mayor's Office of Public Policy and Finance, Controller, and the Board's Budget Analyst.

When implemented, OMB would assume all of the functions and responsibilities listed in this reform proposal that are assigned to the Mayor's Office of Public Policy and Finance, Controller, and the Board's Budget Analyst.

Reform Proposals 4 through 9 are intended to improve the long-term fiscal health of City government and the financial resources available to fund services and programs to San Francisco residents and visitors. These proposals are applicable to the budget process as it currently exists and as it would exist if Reform Proposal 1 (OMB) were implemented.

Reform Proposal 4: Increase the horizon of revenue forecasts from three to five years. This reform proposal is a best practice in budgeting, and is followed by a number of the jurisdictions included in the peer benchmarking research. Specially, five-year revenue forecasts are prepared by the City of San José, City of New York, City and County of Philadelphia, City of Seattle, City of Los Angeles and Los Angeles County. The City and County of Honolulu prepares seven-year forecasts.

Reform Proposal 5: Initiate city-wide financial planning. The financial plan should project revenues and expenditures for all units of City operations for at least five years.

Reform Proposal 6: Identify and implement organization-wide fiscal strategies to create a sustainable financial structure. San Francisco should, while reforming the budget process, also undertake a more thorough examination of specific budget strategies that will improve its financial condition. Some suggested budget strategies are included as Attachment A to this document. Fiscal strategies with the potential for immediate impact should be identified and implemented, and Action Plans prepared for implementation of short-, mid-, and long-term strategies.

Reform Proposal 7: Revise the City's Rainy Day Reserve to ensure that financial resources reserved for economic downturns can be used when they are needed. Ways should be explored to revise the circumstances under which the rainy day reserve can be accessed. Currently, under Charter Section 9.113.5, reserve withdrawals are allowed only if the Controller projects that total General Fund revenues for the upcoming year will be less than those in the current year. If the trigger for withdrawals from the Reserve is not met in the current year, the Controller calculates the shortfall for the upcoming budget year by subtracting the total projected General Fund revenues for the upcoming budget year from the total projected General Fund revenues for the current year. If the trigger for withdrawals from the Reserve is met in the current year, the shortfall shall be c alculated by subtracting the total projected General Fund revenues for the upcoming budget year from the highest of any previous year's total General Fund revenues, plus two percent for each intervening year.

While the intent of the Rainy Day Reserve Fund is laudable, there is no provision for considering inflation as a factor. The formula should be revised to allow for current revenues plus inflation in order to determine whether the reserve fund might be accessed.

Reform Proposal 8: Conduct full cost canalysis of and include sunset clauses in all set-aside ballot measures or initiatives. Modify existing set-asides to maximize flexibility in response to emergencies as well as economic and demographic changes. The City should, to the extent possible, ensure that sunset clauses are a part of each set-aside measure put before the voters by the Mayor or Board of Supervisors. In this way, the set-aside is open to further evaluation in the future, as the government's financial circumstances and public priorities change. The City should also conduct a full cost analysis on each ballot measure that describes its impact for each fiscal year it would be in place. The full cost analysis should be used to educate the public. In addition, a method to adjust current set-asides in response to economic and demographic changes within the City should be developed, including, but not limited to, modification of set-asides in cases of emergency as defined in Section 2.107 of the Charter.

Reform Proposal 9: Implement biennial budgeting. The City and County should implement this practice as it allows for longer-term planning and reduces the administrative

overhead cost of having numerous managers and staffs throughout the City prepare a budget every year. It permits an opportunity to review the results and assumptions outside of the pressure of budget preparation and provides more opportunity to seek consensus on and refine as well as clarify the policies and priorities that should drive the budget.

IMPLEMENTATION TIMELINE

In the previous section, the reform proposals are listed in order of priority and importance. However, actual implementation of individual reform proposals will occur over the next few years based upon a variety of issues including the ability to enact change, the budget process timeline, and election schedules for those items requiring voter approval.

Table 9 summarizes the reform proposals presented in this report and describes a timeline for implementation of each idea. Some will occur during the creation and review of the budget document; others will be implemented following adoption of the budget, during the subsequent fiscal year. If the City follows this schedule, it is possible to implement all reform ideas during the next two fiscal years.

In Table 9, the Reform Proposals are categorized as follows:

- Immediate:
  Implementation can begin during the current FY 2009-2010 budget creation process (September 2008 - June 2009)
- Short-term:
  Implementation can begin during the 2009-2010 fiscal year (July 2009 - June 2010)
- Long-term :
  Implementation can begin during the FY 2010-2011 budget process (September 2009 - June 2010)

TABLE 4: SUMMARY OF REFORM PROPOSALS BY TIMELINE

NO	REFORM PROPOSAL	IMPLEMENTATION TIMELINE		
		Immediate Sept. '08 – June '09	**Short-term** July '09 - June '10	**Long-term** Sept. '09 - June '10
3	Hold joint departmental budget hearings to review department budget submittals with the Mayor's Office and the Board's Budget Committee in mid to late February.	X		
7	Revise the City's Rainy Day Reserve to ensure that financial resources reserved for economic downturns can be used when they are needed.	TBD		
1	Establish a professional Office of Management and Budget (OMB), which will be responsible for annual budget development and financial planning for the City and County of San Francisco, and accountable to both the Mayor and the Board of Supervisors.	TBD		
8	Conduct full cost analysis of and include sunset clauses in all set-aside ballot measures or initiatives. Modify existing set-asides to provide flexibility in response to economic and demographic shifts.		X	
6	Identify and implement organization-wide fiscal strategies to create a sustainable financial structure.		X	
4	Increase the horizon of revenue forecasts from three to five years.		X	
9	Implement biennial budgeting.		X	
2	Establish budget development priorities and guidelines that are adopted by the Board of Supervisors at the start of the annual budget process in September.			X
5	Initiate city-wide financial planning.			X

A summary of the reform ideas contained within the report is provided as Attachment A.

CONCLUSION

Years of repeated deficits, mid-year cuts, contentious budget hearings and growing public frustration illustrate the need for fundamental reform of San Francisco's budgeting process. The City has a budget process that is unique and more complex than other large municipalities and includes sequential, iterative budget review and input by multiple parties none of whom may share the same goals or vision. Currently, there is no point or venue in the process for those differences to be surfaced and reconciled. In addition, set-aside funding greatly reduces the availability of discretionary funds and severely limits the ability of policy makers to adjust the City's financial priorities when necessary. Restoring this flexibility is critical now more than ever given the extreme fiscal challenges and economic pressures facing local government and the national economy.

The focus of the San Francisco budget process is currently one of cuts and add-backs at a macro level, as opposed to thoughtful policy decisions regarding services to be provided to residents, and professional management of resources at the organization-wide level. Meanwhile, managers are placed in the difficult position of attempting to manage and provide service to San Francisco residents and visitors without fiscal stability and under ever-changing policy direction.

While specific fiscal strategies can be implemented to modify service delivery, reduce expenditures or enhance revenue, these will only provide temporary relief. ***In order to maximize limited resources and stabilize core programs the budget process itself must be modified to focus on policy rather than line items.*** This report recommends a process that is more collaborative in approach and more strategic in terms of fiscal oversight and long-range financial planning. The recommendations seek to create the opportunity for an examination of policies and priorities with a focus on identifying and budgeting for core programs. Implementation of these reform proposals will improve the City's functioning in many ways and build a foundation upon which specific fiscal strategies can be implemented with greater likelihood of success.

If City policymakers can agree to reform the current system, everyone will benefit. Key priorities of the Mayor and Board of Supervisors can be identified and funded early in the process. Department managers can receive better direction and undertake long-term planning for their operations to better serve the public. A new Office of Management and Budget can be responsible and accountable for developing a mission-based balanced budget, analyzing new initiatives, fully costing all

proposed personal services contracts and MOUs prior to adoption, identifying cost saving measures, and protecting the longer-term sustainability of the City's finances and its programs. In the end, it is that long-term sustainability, continuity and transparency which the residents and visitors to San Francisco are depending on the local government to deliver, more so now than ever.

ATTACHMENT A – BUDGET STRATEGIES

Member Survey

Management Partners developed and administered an electronic survey to MEA members to develop strategy ideas under three distinct categories, which included:

1. Service Offerings and Delivery Changes
   This includes changing work rules, organizational structure and policies to deliver services at less cost than the current approach. Service offerings and delivery changes also includes items such as the elimination of, or further reduction of, services deemed to be of lesser priority to reduce costs.
2. Expenditure Controls/Shifts
   Expenditure controls and shifts include steps to reduce the growth of the City's expenditures while preserving service levels. These also include shifting various expenditures from the City and County General Fund to other special purpose funds, which may require organizational or operational changes.
3. Revenue Enhancements
   Measures such as raising taxes and fees to increase City revenues are considered revenue enhancements.

A draft survey instrument was developed and a beta version supplied to the MEA Project Steering Committee for review and comment. MEA membership was asked to participate in the development and identification of specific budget strategies. The information provided served as a launching point for a discussion with the Steering Committee about possible strategies that necessitate further study. Prior to meeting with the Steering Committee, Management Partners created and proposed criteria for qualifying and disqualifying budget strategies. The purpose of such criteria will be to provide a clear structure for deciding which strategies were to be chosen for further study.

Strategy Qualification and Categorization

Several questions on the electronic survey asked respondents to prioritize pre-defined budget strategies and provided specific strategies via open-ended questions. A total of 128 individuals took the survey and the respondents articulated more than 170 specific budget strategies ideas and comments on the City and County of San Francisco operations.

Management Partners prepared criteria to assist in qualifying and disqualifying specific strategies for further analysis. *These criteria were not approved and finalized by the Project Steering Committee but are shared here solely for future reference and consideration. As noted in the body of this report, the scope of work for this project changed based on the knowledge that, until the City and County of San Francisco takes significant steps to improve and streamline its budgetary practices, specific budget strategies are unlikely to be successfully adopted and implemented.*

The following criteria can be used to qualify a possible strategy for consideration and further study:

1. Strategy aligns with preliminary benchmarking information, which shows that specific revenue sources or expenditures in the City and County of San Francisco are below or above the peer average (or median).
2. Strategy has been successfully implemented in a best practice jurisdiction or a peer jurisdiction.
3. Strategy is highlighted in prior research, policy papers and studies conducted on the City's operations that have made a convincing argument for change.
4. Strategy targets a practice that is out-dated or out of alignment with current City objectives or planning.
5. Strategy targets a service that is provided by the City, which is duplicative with another service provided at the Federal or State level.
6. Strategy targets a service that is provided by the City, which supplements or supplants a service provided by or policy made by the Federal or State government.

The following criteria can be used for disqualifying a possible strategy for consideration and further study:

1. Strategy cannot be effectively implemented in a cost effective time-frame.
2. Strategy would not reduce deficit or if it does, implementation of the strategy would not be cost effective.
3. Strategy would have a limited impact and cannot logically be combined with other similar strategies.
4. Strategy is not actionable (i.e., not complete and/or represents a belief or theory).

Potential High Impact Budget Strategies

The following budget strategies illustrate a few of the ideas that were generated by MEA members. The items below represent some of the most commonly suggested items and strategies that Management Partners believe will have a significant impact on the City and County of San Francisco's operations. The following strategies do not represent a list of items that the City should implement immediately; instead, they illustrate areas where The City should devote more resources to research, vet, and determine the financial and organizational impacts of successful implementation.

Service Offerings and Delivery Changes:
This includes changing work rules, organizational structure and policies to deliver services at less cost than the current approach. Service offerings and delivery changes also include items such as the elimination of, or further reduction of, services deemed to be of lesser priority to reduce costs. Those items identified by MEA membership include:

- Streamline and make internal service functions more efficient (i.e., purchasing, personnel/civil service)
- Integrate departments, agencies and organizational units with similar functions (e.g., consolidate the maintenance of City facilities into one department)
- Do not use City funds to support services that supplement those already provided by the federal and state governments
- Conduct organization structure and operational reviews to identify additional efficiencies, and implement the recommendations

Expenditure Controls/Shifts:

Expenditure controls and shifts include steps to reduce the growth of City expenditures while preserving service levels. These also include shifting various expenditures from the General Fund to other special purpose funds, which may require organizational or operational changes. Items identified by MEA membership for consideration include:

- Eliminate the practice of forgiving loans to community groups
- Restructure and/or eliminate set-asides
- Revise Rainy Day Reserve Fund policies
- Establish master service agreements with major vendors
- Ensure that MOU costs can be covered by revenue projections
- Implement multi-year budget and financial planning
- Establish a policy to require consideration of long-term administrative and support costs before new programs are established

Revenue Enhancements:

Measures such as raising taxes and fees to increase City revenues are considered revenue enhancements. Some of those revenue enhancements identified by MEA membership during this review include:

- Close business tax loophole for partnerships – Passed on November 4, 2008 ballot
- Increase property transfer tax on commercial buildings – Passed on November 4, 2008 ballot
- Establish a City-wide Lighting and Landscaping District
- Establish a regional gas tax to support street maintenance and MUNI (transportation)
- Increase taxes and fees (e.g., hotel tax, MUNI transportation fees)
- Develop special assessment districts for Fire services